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The Minnesota Budget and Inflation

JAMES CECIL *

ABSTRACT — The Minnesota state budget is a policy document which reflects programmatic priorities of the state in terms of size, direction and rank order. Major causes for budget increase are inflation and increased state conversion of what were once local government programs into joint programs. Accompanying greater state support is more state regulation through the use of uniform statewide standards. The two most important Minnesota services are education and welfare. Concern for property tax burden by the legislature has resulted in a comprehensive property tax relief program. Because these programs are very costly, Minnesota, except for property and sales, is a high tax state.

All levels of government, federal, state and local, have been raising and spending ever increasing amounts of money, mostly from taxes, for decades (Table 1). Between 1902 and 1973 state tax collection increased 43,500%. Local government tax increased 7,400% and federal tax collection increased 32,300%. Minnesota is no exception to this trend. As indicated in Table 2, the total Minnesota budget increased about 66 percent between 1975 and 1983.

While all governmental budgets increased over the past several years, state and local spending accelerated the most, with the state budget growing more rapidly than the local budgets. There were several reasons for the mounting budget. A growing population resulted in increased governmental services. Existing programs expanded and many new services were added (e.g., broad-based opportunity for higher education). And, states assumed what once were local government services (e.g., education and welfare), thus allowing local budgets to grow much more slowly than state budgets. Inflation also increased costs because governmental units had to appropriate more of the inflated dollars to buy the same services.

Relationship between Budgets and Inflation

The Minnesota budget is for two fiscal years, a biennium. As Table 3 shows, the relationship between budgets and inflation is not always direct. Notice that the annual inflation rate (Column

3) went from a low of 6.2 percent in 1976 to over 12 percent by 1981. Part of the budget increase was to make up for the decreased value of the dollar. The general fund also increased, from about \$3.5 billion in 1975 to almost \$8 billion by the end of the 1981-83 biennium. Table 3 also shows that except for property tax increases the budget and taxes have tended to increase at a higher rate than inflation until 1979-80. There was an increase every year; the question apparently was not if there would be an increase, but rather how much that increase would be.

Adjustments in Tax Increases

In Minnesota one of the most effective revenue producers has been the income tax. This is especially true during inflation; the more inflation, the higher the increases and higher the tax rate, all without the legislature having to vote for higher taxes. The automatic nature of the income tax increase became one of several campaign issues in 1978. Many candidates, the Independent Republican Party, and the media advocated a change in the income tax. During the legislative session of 1979, a remedy was applied. This remedy, indexing or indexation, acts on "bracket creep" by freeing the tax rate from inflation. The tax rate then is not directly tied to the rate of inflation but rather to a formula which tends to set the tax rate lower than the inflation rate. By the end of the 1981-83 biennium indexing was projected to save Minnesota taxpayers \$543 million in income taxes. The effect was

Table 1. Total Tax Collections, 1902, 1927, 1938, 1948, and 1973 (1)

Level of Government	Millions of Dollars					Percent Increase
	1902	1927	1938	1948	1973	
Federal	\$513	\$3,364	\$5,344	\$37,876	\$165,493	32,300%
State	156	1,608	3,132	6,743	68,069	43,500
Local	704	4,479	4,473	6,599	53,032	7,400

Table 2. Minnesota Gross Budgets 1975-1983 (In Millions) (2)

Biennium	Total Budget	State Amount	%	Federal Amount	%	Percentage Change Over Prior Biennium		
						Total	State	Federal
1975-77	\$7,406,757	\$6,221,194	84	\$1,185,563	16	31%	52%	-2%
1977-79	9,008,177	7,500,900	83	1,507,277	17	22	21	27
1979-81	11,022,026	9,101,479	83	1,920,547	17	22	21	27
1981-83	12,305,607	10,234,754	83	2,060,853	17	12	12	07

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Table 3. Consumer Price Index (CPI), Budgets and Tax Collections (1967 = 100) (3).

Year	CPI for Mpls St. Paul Metro Area	Purchasing Power of Dollar	Annual % Change Mpls.	% Increase of State Share of Total State Budget	% Increase Total State Budget	% Increase of General Fund	% Increase in MN State Income Tax Collection	% Increase of MN Property Tax Collect.	General Sales Use Tax Collection
			St. Paul Metro Area (Inflation Increase)						
1975	160.9	.62	8.5	26	15.5	21.5	15.01	16.6	10.24
1976	170.9	.59	6.2	26	15.5	21.5	5.25	3.6	11.41
1977	183.0	.55	7.1	10.5	11.0	11.5	12.59	12.2	9.40
1978	199.7	.50	9.1	10.5	11.0	11.5	12.35	4.2	15.39
1979	222.6	.45	11.5	10.5	11.0	6.5	16.28	5.8	14.37
1980	247.8	.40	11.3	10.5	11.0	6.5	1.25	.2	6.71
1981	278.3	.36	12.3	6.0	6.0	3.5	-	-	-
1982	-	-	-	6.0	6.0	3.5	-	-	-

felt as early as 1980 (Table 3, Column 7).

High taxes were but one of several state financial problems of the late 1970s. An additional concern in many states, including Minnesota, was an inflated budget based on declining revenues. Complaints about automatic income taxes soon gave way to cries of alarm over diminished tax receipts. These almost continuing economic crises were finally alleviated by cuts in funding, surtaxes, delays in payment to local governments, and increases in sales tax. In short, mostly short term solutions were offered for presumably short term financial problems.

Adjustments and Priorities

The Minnesota budgets of the past few years have emphasized continuing support of education, property tax relief, aid to local governments, and social services including welfare. To fund these costly programs, Minnesota has for several years relied heavily upon the big three taxes: individual income tax, corporate income tax and sales tax. These three represent about 70 percent to 85 percent of the total tax take during recent biennia (Figure 1). Individual income tax has been the largest, averaging nearly 50 percent of general fund tax revenues.

Federal funds have long been an integral part of the total Minnesota financial picture. Some federal funds are included in the state budget; other payments bypass the state and are either paid directly to the individual (e.g., pensions and other types of transfer payments), or are distributed to subsidiary units of government.

Perhaps one of the most visible and enduring types of expenditures is grants-in-aid funding. This approach provides that certain kinds of programs are jointly funded, according to formula, by federal, state and local dollars. A good example of this approach is the Medical Assistance (MA) program. About 56 percent of this program is financed by federal funds; the state's share is 90 percent of the non-federal share, and the remaining 10 percent is from the county. There are about 57 or so grant-in-aid, revenue-sharing and similar programs. The total amount of federal funds of all kinds expended in Minnesota in 1979 exceeded \$7.3 billion.

For every federal dollar that Minnesota state and local governments received, the Minnesota taxpayer paid \$.98 in federal taxes. For that same dollar, a taxpayer in Mississippi paid \$.53 and a taxpayer in Indiana paid \$1.41. Neighboring states vary somewhat. Wisconsin pays less, (\$.92) and Iowa pays more (\$1.20) than Minnesota. North and South Dakota pay considerably less than Minnesota, Wisconsin and Iowa (\$.71 and \$.62, respectively). The ideal, from the standpoint of the state, is to pay low

taxes and collect many federal dollars. However, most federal funds are tied to grants with the goal of redistributing income among states so that programs are about equal in quality. Richer states, as measured in terms of fiscal capacity, pay more and get less; conversely, poorer states pay less and get more.

Revenue Sharing

Another source of federal funds for the states, revenue sharing, was first utilized in 1972. This is an approximate synonym for an unconditional or general-purpose grant. A revenue-sharing grant allows the recipient government great freedom in how the funds are spent. This approach to the distribution of federal funds recognizes that the federal government is very good at raising money, but the state and local governments are much better at determining the best way to use it.

In 1979, Minnesota and its local governments received about \$1.1 billion in revenue-sharing funds. Because these funds are encumbered with relatively few requirements, local governments have used them for a variety of purposes, at the same time being careful not to jeopardize future receipts. There is also a fear that these funds might be terminated by Congress and already hard-pressed governments would need to find replacement money or cut the programs.

The General Fund Reflects State Income and Expenditure

General fund budgets provide an indication of the major programs in Minnesota (Figure 2). Education has and continues to be the most costly. The legislature appropriated more than \$2.8 billion in 1979, and, including various fees, spent slightly over \$3 billion for education. The percentage of the general fund was not constant, however. Education's share of the general fund dollar dropped from 44% in 1975 to 35% in 1981. This decline was not due to less money but rather to smaller dollar increases. Increases were reduced for two reasons: 1) a sharp decrease in school enrollments reduced the total need, 2) local districts could contribute a greater share without raising the mill levy because property evaluations went up. Therefore, the state could provide about the same or even superior programs for smaller increases.

Tax relief, one of the continuing concerns for the legislature and the second largest item in the general fund, experienced somewhat of a boom and bust pattern (Figure 2). The state has become both a collector of taxes and distributor of funds to local governments. By contrast, local government's function of gathering taxes for

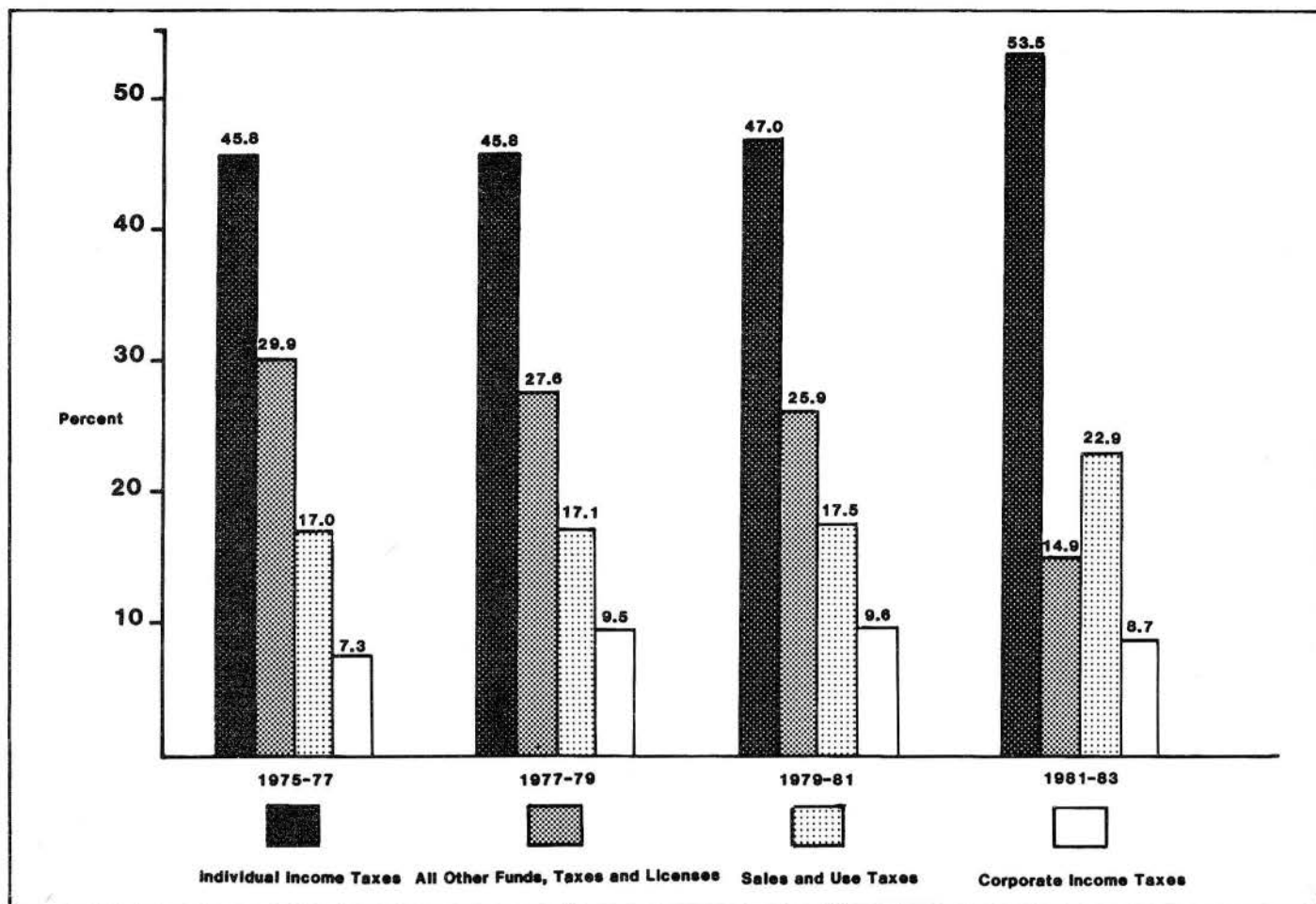


Figure 1. Estimated general fund resources for the state of Minnesota, 1975-83. Data from (4,5).

"local services" is declining as it lobbies the state government for more aid money. Since 1967 the legislature has provided property tax relief (Homestead Credit) to the individual taxpayer, and in return has reimbursed the local governments for lost property tax revenue. This contributes to Minnesota's property tax rank of 22nd to 25th in the nation (Table 4). A controversial revision of property tax relief called the "circuit breaker," which provides for an income-adjusted property tax credit for homeowners, renters, the disabled, and senior citizens, was instituted in 1975. As recently as 1979-81 the total cost for these relief programs exceeded

\$2 billion — equal to about half of the income tax collected during the same biennium. This included more than \$616 million of Homestead Credit and not quite half a billion for the circuit breaker.

Welfare, the third largest item, is also a multibillion dollar program. For the 1979-81 biennium the state general fund provided more than \$1 billion, and with the addition of the federal share, welfare costs exceeded \$2 billion. Welfare increased from 13.5 percent of the general fund budget in 1975 to 20 percent in 1981.

Table 4. Minnesota Rank By Selected Per Capita Financial Items (6)

Item	State Rank, 1974-1982								
	1974	1975	1976	1977	1978	1979	1980	1981	1982
Education	6				17	16	17	20	
Expenditures									
Higher Education	11		14	17	18	26	22	23	
Public Welfare	11		8	10	9	10	9	7	
Highways	26		17	15	13	13	12	12	
State and Local	13	8	9	8	9	12	7	6	5
Expenditures									
All Taxes, state and	9	8	8	9	9	8	9	11	10
Local									
Individual Income Tax	4	3	4	5	5	3	6	7	4
Corporation Net	3	4		6		4		6	8
Income Tax									
General Sales Tax	37	35	36	38	37	35	37	36	20
Property Tax	22	22	24	23	23	23	22	22	25
Personal Income	19	21	21	16	19	18	17	18	

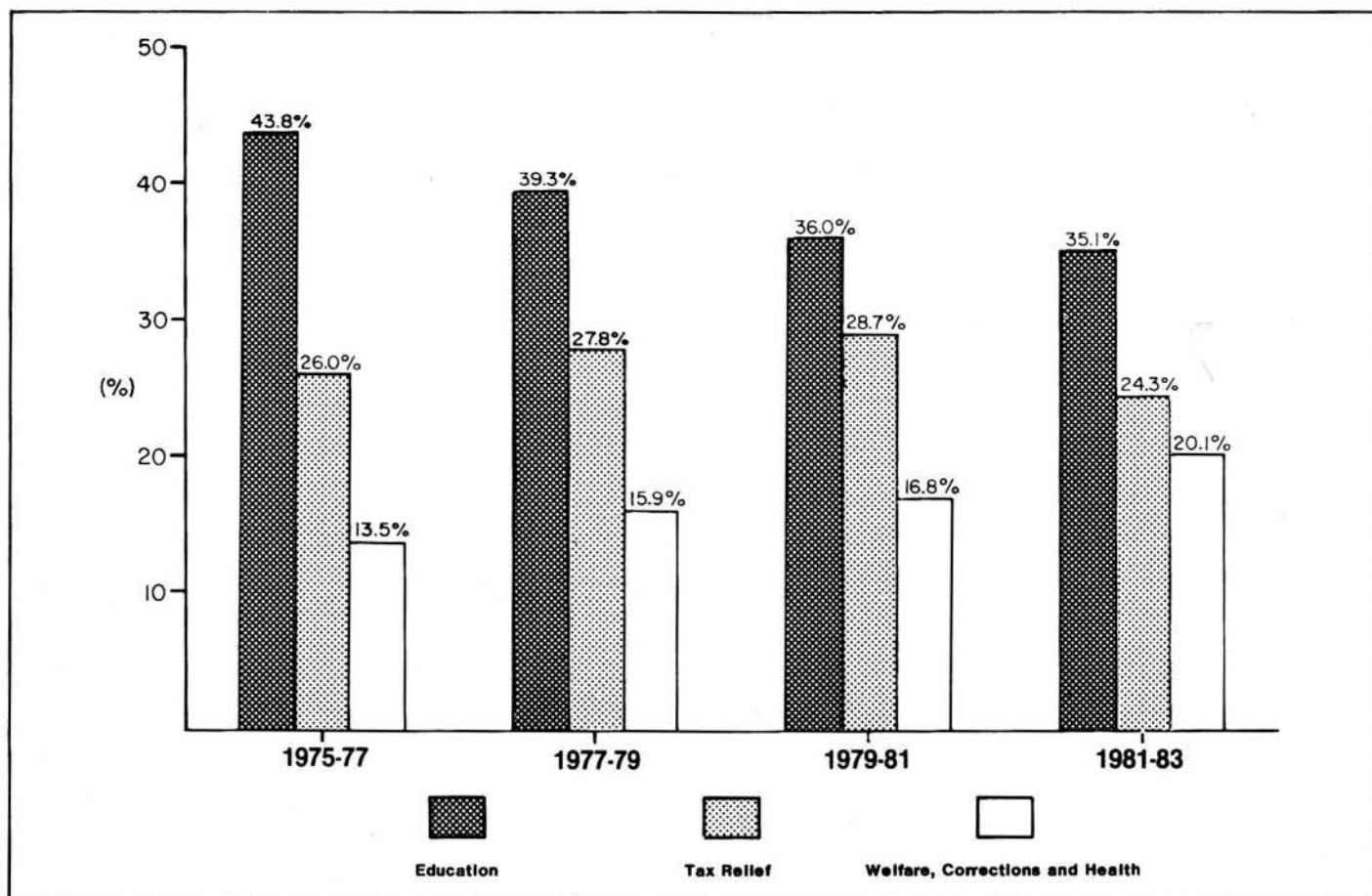


Figure 2. General fund allocations for education, tax relief and welfare, corrections and health in Minnesota, 1975-81. Data from (4,5).

Minnesota as a High Tax State

To better understand Minnesota taxing and spending patterns, it is necessary to compare them with other states. Table 4 compares Minnesota to other states in rank order of selected items on a per capita basis. For example, Minnesota state and local government ranks about 5th or 6th in general expenditures, up from 12th in 1979. Minnesota spending on education hovers around 16th or 17th, a substantial decline from 6th in 1974-75; it drops even lower (to 23rd) in spending for higher education, again a major drop from 11th in 1974-75. Minnesota spending for welfare and highways is high in the national comparison. Overall public welfare spending is 7th, up from 19th in 1974-75, and highway spending is up to 12th from 26th in 1974-75.

Legislators are reluctant to increase taxes. This is why the income tax is popular; the increase is automatic and with inflation revenues are generated at a growing rate. As of 1979, indexation has considerably reduced these increases in Minnesota. Principles (values) also apply to taxation policy; decisionmakers, for example, discuss basing taxes on ability to pay. Collectability (avoidance) is another issue. Retail sales taxes are automatically applied, and payroll deduction taxes are immediately withheld.

In order to finance services, Minnesota citizens pay relatively high taxes. Minnesota in 1983 was 11th in all taxes, state and local. In 1979 it was third in individual income taxes, fourth in corporation income taxes, but thirty-fifth in general sales tax collections (Table 4). Since Minnesota ranked twenty-third in receipt of federal funds, only slightly above average, it must rely heavily upon its own taxes. That condition holds true in the entire midwest. Minnesota's reputation as a high tax state is a fair one, and accompanies Minnesota's tradition of providing quality services based on the income tax and on the principle of "ability-to-pay." The relatively low ranking of the general sales tax is par-

tially due to the system of tax exemptions, which further reinforces the ability-to-pay tradition. These taxes have been burdensome to Minnesotans especially when it is remembered that the state is nineteenth in per capita personal income.

In retrospect, the early 1970s, the years of increasing taxes and spending, may have been the high point of state services and programs. Symptomatic of changing economic conditions, at least in Minnesota, was the determined and successful effort to index the income tax. This feeling undoubtedly was a harbinger of the financial crises of the early 1980s. Minnesotans discovered that they weren't recession-proof; tax collections fall off during hard times and major programs are difficult to finance. For elected officials, the next few years may be periods of introspection, requiring much hard thinking about program priorities and size, and, above all, the politics of financing these programs.

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